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AIR FARES - AIR CANADA AND CP AIR

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AIR FARES - AIR CANADA AND CP AIR

Table of Contents

Page

Foreword... 1

Introduction....................................... 4

Air Fares - Air Canada and CP Air.................. 6

Canadian Air Transport Policy.............. 6

North American Air Fares................... 8

International Air Fares.................... 10

Financial Performance...................... 11

Conclusion... 16

FOREWORD

The Prices and Incomes Commission was established on June 19, 1969, "to inquire into and report upon the causes, processes and consequences of inflation and to inform those making current price and income decisions, the general public and the Government on how price stability may best be achieved".

Following numerous separate discussions with representatives of the Canadian business community, including the Canadian Chamber of Commerce, the Canadian Manufacturers' Association, the Retail Council of Canada and the Canadian Bankers' Association, the Commission decided to call a National Conference on Price Stability in order to obtain a consensus on a national policy to combat inflation. The conference, held in Ottawa on Feb. 9-10, was attended by senior officers of national business and farm associations, representatives of professional groups, leaders of the Canadian business community and officials of the federal and provincial governments. Those present indicated a willingness to exercise a meaningful degree of restraint in their pricing policies in 1970 and there was broad agreement that:

...2

(a) Business firms generally, if called upon to do so, would reduce the number and size of price increases they would normally make in 1970.

(b) More specifically, where higher prices are needed to cover higher costs, and market conditions make them feasible, business firms generally, if called upon to do so, would ensure that price increases were clearly less than the amount needed to cover the increases in costs at a normal volume of output and sales.

The complete list of agreed criteria is contained in the Closing Statement of the National Conference on Price Stability released on Feb. 10, 1970.

At a Federal-Provincial Conference of First Ministers, held in Ottawa on Feb. 16-17, 1970, the federal government and all provincial governments endorsed the Commission's plan to call without delay upon business firms generally to follow the basic price restraint principle adopted by the National Conference on Price Stability. First Ministers urged all Canadians to co-operate actively in restraining price and income increases during 1970.

...3

Provision was made at the National Conference on Price Stability for a price review procedure whereby the Prices and Incomes Commission would review price increases to determine whether they comply with the agreed criteria.

The Government of Canada and most provincial governments expressed the hope that government sanctions would not be required but agreed that if necessary they would use such means as are within their control to deal with cases of serious non-compliance with the pricing criteria as reported by the Commission.

INTRODUCTION

Air Canada and Canadian Pacific Air Lines Ltd. informally approached the Prices and Incomes Commission in March, 1970, to discuss proposed revisions to passenger fares and freight rates on certain air routes in Canada to be effective June 1, 1970. The companies said revisions were necessary to increase operating revenue and to achieve a more adequate return on investment. A number of discussions were held with each of the two companies. Operating results for prior years and projections for 1970 were reviewed.

Following their discussions with the Commission, Air Canada and CP Air filed revised tariff schedules with the Canadian Transport Commission for passenger fares and rates on air routes in Canada effective Aug. 5, 1970.

The revised schedules contain a number of fares which are substantially reduced from the levels originally shown to the Commission. For example, fares for certain short-haul routes (under 300 miles) which are heavily travelled were originally proposed at higher levels than now are scheduled. It was felt that the fares originally indicated would increase costs to travellers using these routes to a disproportionate degree.

The revisions, which include both increases and decreases in passenger fares, have been designed as a step towards rationalization of the passenger-fare structure

through the application of a formula which includes a terminal charge and a per-mile rate. In addition to adjustments on normal passenger fares other modifications are being made, including changes in the discount rates offered to certain travellers who qualify under stand-by family and group-fare plans.

Some adjustments in trans-border passenger fares and freight rates are expected to be made later in the year.

The Prices and Incomes Commission undertook this review to determine whether the rate revisions comply with the agreed criteria. Detailed information on revenue, cost and profit performance has been obtained from the two companies.

The criteria stipulated that 1969 would, in general, be used as the base year when considering changes in costs and revenues. The closing statement of the conference provides, however, that "in cases where this would be clearly inappropriate, a suitable alternative base period would be selected". In the case of the two air lines concerned 1969 is not an appropriate base year because results were seriously distorted as a result of a strike which grounded all Air Canada aircraft for one month. This resulted in lower revenues for Air Canada but directed additional traffic to CP Air causing inflated revenues and profits for that company. Accordingly, 1968 has been used as the base year for both companies.

AIR FARES - AIR CANADA AND CP AIR

Canadian Air Transport Policy

The existing policy governing civil aviation in Canada requires Air Canada to fill a major role in providing domestic services, including the transcontinental route and a variety of other services. CP Air is authorized to operate services which provide up to 25 per cent of the total transcontinental capacity, with stops at Montreal, Ottawa, Toronto, Winnipeg, Calgary, Edmonton and Vancouver. CP Air also offers services to other points in Western and North-Western Canada.

In addition, five regional carriers provide regular route operations into the north and operate local or regional routes to supplement the domestic main-line operations of Air Canada and CP Air. The regional carriers are restricted from becoming directly competitive on any substantial scale with the two main-line carriers. Routes which do not fit the type of main-line operations of Air Canada or CP Air are generally reserved for regional carriers.

A degree of co-operation exists between the regional and main-line carriers in such fields as joint fare and commission relationships, technical and servicing arrangements, inter-connections, joint use of reservations, advertising and sales activities.

In regard to domestic charter operations, certain restrictions are applicable to the regional carriers providing services over the routes of the main-line carriers.

In the international field the policy on scheduled air services provided by Canadian airlines is designed to serve the Canadian interest as a whole, to ensure that these services are not conflicting, but represent a single, integrated plan. The Pacific Area, the continent of Asia, Australasia, Southern and South Eastern Europe and Latin America were allocated to CP Air; the United Kingdom, Western, Northern and Eastern Europe and the Caribbean to Air Canada. The only exception to this division is that CP Air serves the Netherlands. Services to points in the United States are provided principally by Air Canada, with CP Air providing the service between Vancouver and San Francisco and Canada and Honolulu.

In the international charter area certain regional and other carriers are authorized to offer services which do not unduly affect the scheduled international services of Air Canada and CP Air.

North American Air Fares

The principal feature of the passenger tariff revision effective Aug. 5, 1970, is a move toward a formula consisting of a uniform charge of $10 for each flight plus 5.7 cents per mile. The resultant economy fares involve both increases and decreases from those in effect prior to the change. On short-haul sectors, however, fare increases have been limited to $1 on journeys up to 150 miles and $2 between 150 and 300 miles to avoid particularly high percentage increases which would arise through the application of the formula.

The revisions involve fare increases in 150 Air Canada routes, decreases on 410 routes, while 27 fares remain unchanged. The CP Air revision includes increases on 19 routes. First-class fares are all established at 135 per cent of economy rates.

Other revisions in passenger fares include a \$5 charge for each stopover of more than four hours unless required for connection; adjustment of discounts available on family fares, group fares and youth and senior citizen stand-by fares. A new individual contract excursion fare is being introduced which provides a 25-per-cent discount for passengers purchasing tickets two months in advance for a journey of between 14 and 28 days.

Canadian air freight rates are increased in the under-100-pound category, while two new weight breaks are introduced at the 200- and 400-pound levels. The under-100-pound rate will be increased by one cent per pound, while the 400-pound rate continues at the present level. The 200- and 100-pound rates are increased by up to two and four cents per pound respectively, depending on distance. Commodity rates will remain unchanged but the minimum qualifying weight will be increased to 200 pounds.

The weighted average effect of the passenger and freight adjustments is an increase of approximately six per cent for each company. Additional revenues of about \$7,000,000 are expected by Air Canada in 1970 and \$1,000,000 by CP Air as a result of the revisions.

The previous major revision in domestic fares in Canada occurred on April 26, 1968, increasing normal fares by 10 per cent and adjusting discount fares. Prior to that date no major revision had been made since April 1, 1962, when fare increases ranging from $1 to $10 were effected.

Domestic fares in the United States were increased by three per cent in 1962 but remained basically unchanged until Feb. 2, 1969, when a general increase of 3.8 per cent was effected. This was followed by a further 6.4-per-cent general increase in October, 1969.

Some adjustments in trans-border passenger fares and freight rates are expected before the end of 1970 but the revenue effect in this year is not expected to be significant.

International Air Fares

International fares are the subject of negotiation and agreement by the members of the International Air Transport Association. Trans-Atlantic carriers have filed for increases of $5 each way to be effective on Sept. 1, 1970.

Financial Performance

Air Canada is wholly-owned by Canadian National Railways. CP Air is wholly-owned by the Canadian Pacific Railway Co.

The published financial performance of the two companies for recent years is summarized in the following table.

Air Canada

Summarized Financial Data
1965 - 1969
(millions of dollars)

	1965	1966	1967	1968	1969
Operating Revenues	$250.1	$290.0	$345.6	$387.6	$404.6
Operating Expenses	237.4	276.0	329.7	359.6	386.2
Net Operating Income	12.7	14.0	15.9	28.0	18.4
Interest Costs ( )	(10.9)	(10.5)	(11.4)	(14.6)	(20.5)
Non-operating income	2.2	2.3	2.6	3.0	5.2
Income before tax	4.0	5.8	7.1	16.4	3.1
Income after tax	$2.0*	$2.9	$3.5	$8.2	$1.5
Income after tax as % of revenue	0.8%	1.0%	1.0%	2.1%	0.4%

* Profits in 1965 have been adjusted to reflect consistent income tax treatment.

Canadian Pacific Air Lines Ltd.

Summarized Financial Data

1965 - 1969
(Millions of dollars)

	1965	1966	1967	1968	1969
Operating Revenues	$72.0	$82.6	$95.2	$106.7	$133.7
Operating Expenses	63.6	72.8	89.3	98.8	122.0
Net Operating Income	8.4	9.8	5.9	7.9	11.7
Interest Costs ( )	(2.0)	(1.8)	(1.8)	(3.8)	(5.4)
Non-operating income	.8	1.3	1.6	.8	.9
Income before tax	7.2	9.3	5.7	4.9	7.2
Income after tax	$3.6*	$4.6*	$2.9*	$2.4	$3.5
Income after tax as % of revenue	5.0%	5.6%	3.0%	2.2%	2.6%

* Profits in years prior to 1968 have been adjusted to reflect consistent income tax treatment.

The review by the Commission of costs and revenues of the two companies was directed at results of both the total system and North American operations.

A review of Air Canada's financial performance shows that projected net operating income for 1970, including the fare revision effective Aug. 5, is expected to be only slightly higher than in the base year 1968, although the volume of revenue and traffic is significantly higher. Operating profits per available

ton-mile and per revenue ton-mile in 1970 are well below 1968 levels. Projected income after tax in 1970 will be well below the $8,200,000 reported for 1968.

In 1970 operating expenses are 28 per cent or $100,000,000 higher than in 1968. This increase includes costs of additional personnel, equipment and other facilities, and operating costs associated with the significantly higher capacity provided.

In the last three years Air Canada's personnel costs have accounted for over 40 per cent of total operating expenses. The 1968 and 1969 levels were about four percentage points higher than those of 1965 and 1966. The following table shows the trend in average personnel costs per employee for the years 1965 to 1970.

Air Canada

Trend of Average Personnel Costs Per Employee
(1965=100)

	Index	Increase over previous year
1965	100	-
1966	104	4
1967	113	9
1968	122	7
1969	128*	5*
1970 (estimated)	142	10

* Personnel costs in 1969 were depressed as a result of the strike which grounded all Air Canada aircraft for one month.

The increase in average cost per employee will account for about $27,000,000 of the total cost increase of $100,000,000 between 1968 and 1970.

Because of the greater volume, larger aircraft and improved efficiency, wages, salaries and benefits are expected to be lower per ton-mile in 1970 than previously.

Interest costs will rise appreciably from $14,600,000 in 1968 to $27,100,000 in 1970. This increase of $12,500,000 largely reflects the financing which was necessary to acquire additional equipment and expanded facilities which now are in use. It should be noted that interest paid on funds required for progress payments on aircraft and other facilities not yet in use is capitalized with costs of such assets and not charged against current earnings.

Turning to the operating performance of CP Air it will be noted, as in the case of Air Canada, that a significant increase in revenue has occurred in recent years. Estimated net operating income for 1970 will be marginally higher than for 1968, but on revenue which is 40 per cent higher. Operating profits per available ton-mile and per revenue ton-mile in 1970 will be well below the 1968 levels. On a profit-after-tax basis

the 1970 projection, including the Aug. 5 fare revision, is well below that of 1968.

Operating expenses for 1970 are expected to be $40,000,000 higher than for 1968, again reflecting costs of additional personnel, equipment and facilities and the operating costs associated with higher mileages.

The trend of average personnel costs per employee for the years 1965 to 1970 follows.

CP Air

Trend of Average Personnel Costs Per Employee

(1965=100)

	Index	Increase over Previous Year
1965	100	-
1966	104	4
1967	109	5
1968	115	6
1969	126	9
1970 (estimated)	134	6

The increase in average cost per employee will add about $7,000,000 to costs in 1970 compared with the base year 1968.

Because of greater volume, larger aircraft and improved efficiency, personnel costs per ton-mile in 1970 are expected to approximate the levels experienced in recent years.

Interest costs will increase from $3,800,000 in 1968 to $6,600,000 in 1970, reflecting the additional capital required to expand facilities.

CONCLUSION

The proposals which had originally been placed before the Commission to become effective on June 1, 1970, involved a number of substantial increases in high-density short-haul routes and relatively smaller increases for longer routes. They also contained a substantial number of fare reductions.

The fare schedules effective Aug. 5, 1970, contain lower fares for certain heavily travelled short-haul routes than originally proposed. The net additional revenues which will accrue to both Air Canada and CP Air are clearly less than the additional costs in 1970 compared with the base period. Both companies therefore meet the price criteria.